No. 75-922

In the Supreme Court of the United States

OCTOBER TERM, 1975

BANKERS TRUST COMPANY, ET AL., PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

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The sole question presented by the petition in this federal income tax case is whether the fair market value of 163,570 shares of petitioner's[1] stock it received in settlement of various claims should be determined by reference to the mean price at which the stock was traded on the American Stock Exchange on April 22, 1960, the date on which petitioner first acquired a fixed, unconditional and enforceable right to receive the stock and the proper date for accrual of the income, or, as petitioner urges, by such price on February 19, 1960, the date on which a conditional agreement was reached by the boards of directors of petitioner and the transferor corporation.

The pertinent facts are as follows: In 1939 petitioner leased lands containing iron ore deposits to Reserve Mining Company ("Reserve") in return for one-third of

[1]For convenience, we refer to Bankers Trust Company and the Trustees of the Trust holding the assets of Mesabi Iron Company, Dissolved, as "petitioner" (see Pet. App. 1a).

the net profits obtained from the lands (Pet. App. 2a). Numerous disputes arose between petititioner and Reserve concerning Reserve's computations of net profits, and arbitration proceedings and litigation ensued, including a derivative action brought by petitioner's stockholders. Petitioner also brought an antitrust action against Reserve's two shareholders, Republic Steel Corporation and Armco Steel Corporation (Pet. App. 3a-5a).

On February 18, 1960, the negotiators for petitioner and Reserve reached an agreement under which petitioner would receive $400,000 and all of Reserve's stock in petitioner (163,570 shares), petitioner would drop all its claims against Reserve and its shareholders, and the 1939 lease agreement would be modified to provide petitioner with royalties of $1 per ton of iron ore shipped. At Reserve's request, the tentative agreement provided that it would not become effective until approved by a majority of petitioner's outstanding shares, excluding the shares owned by Reserve. The closing was to take place on the fifth business day following approval by petitioner's shareholders. On February 19, 1960, Reserve's directors and its two shareholders and petitioner's directors approved the proposed settlement (Pet. App. 6a). On April 22, 1960, petitioner's shareholders approved the proposed settlement, and on April 27, 1960, petitioner received from Reserve $400,000 and 163,570 shares of petitioner's stock (Pet. App. 8a-9a).

On its 1960 income tax return, petitioner acknowledged that it had received income from the settlement,[2] declaring the shares to have been worth $5,908,966.25 (163,570 shares at $40.375 each—the February 18, 1960 closing price on the American Stock Exchange) less a blockage discount of $4.25 per share. On audit, the Commissioner of Internal Revenue determined that the proper

[2]Petitioner agrees that in these circumstances it realized taxable income upon the receipt of its own shares. Thus, the correctness of the principle stated in Treasury Regulations, Section 1.311-1(e) (26 C.F.R.) is not at issue here.

date for valuing the stock was April 22, 1960, when petitioner's shareholders approved the settlement, and that that value was best evidenced by the mean trading price on the American Stock Exchange that day, *i.e.,* $78.25 (Pet. App. 9a). The Court of Claims, with one judge dissenting, upheld the Commissioner's position that the proper valuation date was April 22, 1960 (Pet. App. 10a-15a), and that the value of the shares on April 22, 1960, was the mean trading price on that day, $78.25 (Pet. App. 15a-23a).

1. Petitioner argues (Pet. 8-11, 17-19) that because a conditional, preliminary agreement was reached by the boards of directors on February 19, 1960, a date on which petitioner's stock was traded on the American Stock Exchange at approximately $40 per share, that market price should control for tax purposes rather than the $78.25 stock exchange price which prevailed on April 22, 1960, the date on which petitioner's shareholders approved the agreement and petitioner's right to receive the stock first became fixed. The Court of Claims correctly held that petitioner's position that the valuation date need not be the same as the income date "runs counter to the basic principle that under the federal income tax system items are taken into income at their then current value" (Pet. App. 10a). The decision accords with *Amerada Hess Corp.* v. *Commissioner,* 517 F.2d 75 (C.A. 3), certiorari denied *sub nom. White Farm Equipment Co.* v. *Commissioner,* No. 75-375, December 15, 1975, which involved a similar issue. See also *Fordyce* v. *Helvering,* 76 F.2d 431 (C.A.D.C.), and *Philadelphia Park Amusement Co.* v. *United States,* 126 F. Supp. 184, 189 (Ct. Cl.).

Until petitioner's shareholders ratified the conditional agreement reached by the boards of directors, the transaction was wholly executory. Nothing of substance occurred or was intended to occur under the settlement until the transaction was ratified by the shareholders. Indeed,

one of the events leading up to the transaction was a derivative suit against both Reserve and the then directors of petitioner.

2. Contrary to petitioner's argument (Pet. 12-15), the decision below does not conflict with *Herbert J. Investment Corp.* v. *United States*, 360 F. Supp. 825 (E.D. Wis.), affirmed *per curiam*, 500 F.2d 44 (C.A. 7). There, the parties executed an agreement on February 26, 1968 (the "agreement date"), which provided for the sale of tangible and intangible assets. The agreement provided that all profits and losses were to accrue solely to the purchaser from the time of transfer of temporary control, and that interest was to be paid to taxpayer-seller from that time until final consummation of the arrangement. Pursuant to Interstate Commerce Commission authority, on April 1, 1968 (the "transfer of control date"), temporary control was assumed by the purchaser, and thereafter the purchaser had a free hand in conducting the business.

The taxpayer reported the sale of assets "as completed for tax purposes" on April 1, 1968, the transfer of control date. However, on audit, the Internal Revenue Service treated the transaction as complete for tax purposes on August 30, 1968 (the "closing date"), the date of final consummation of the agreement (360 F. Supp. at 826). The court held that the proper valuation date was April 1, 1968, the transfer of control date.

In *Herbert J. Investment*, as in the present case, the court accorded no tax significance to the "agreement date." Moreover, petitioner ignores the fact that in *Herbert J. Investment*, the valuation date approved by the court was the time at which beneficial ownership changed. In its opinion in *Herbert J. Investment*, the district court stated (360 F. Supp. at 827-828):

> A sale may be completed for tax purposes despite the existence of future contingencies. * * * The time of transfer of dominion and control over assets which are the subject of a sale is a more important consideration than the time of ultimate payment or conveyance of formal title.

Necessarily embraced in the court's holding, therefore, is the finding that the sale was completed for tax realization and valuation purposes as of April 1, 1968.[3]

In this case, however, petitioner conceded that under its accrual method of accounting the proper reporting date for the income in question was April 22, 1960, the closing date. In its motion for rehearing in the Court of Claims, petitioner attempted to withdraw that concession, which was made in October, 1971, renewed during the trial of this case and made again in petitioner's brief to the Court of Claims (see Pet. App. 10a). But apart from the ineffectiveness of that belated attempt, petitioner's concession was compelled by the facts in this case and the controlling legal principles.

The express condition of the settlement agreement requiring that the proposed agreement be approved and authorized by the affirmative vote of a majority of the outstanding shares of petitioner (excluding from the majority the shares owned by Reserve) was a condition upon which Reserve insisted. It was in accordance with peti-

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[3]This is also demonstrated from the brief of Herbert J. Investment Corporation in the court of appeals, which stated (p. 15) that the question of when the sale was completed for tax purposes was before the court:

> The basic legal question here is when, on the facts of this case, the sale was effective for tax purposes—whether the time of the sale of the assets and operating rights of the taxpayer was on August 30, 1968, the date of formal conveyance and passage of title, as the government contends, or as taxpayer contends, on April 1, 1968, the date the parties intended to pass beneficial interest, and did in fact pass the benefits and burdens of ownership to the purchaser.

tioner's previously established policy of obtaining stockholder approval for any substantial modification of the contractual relationship between petitioner and Reserve (Pet. App. 57a). Additionally, stockholder approval was necessary to ensure that one of the law suits, a stockholder derivative action, would be dismissed by the Delaware Court of Chancery (Pet. App. 42a). It was also necessary to ensure compliance with Title 8, Section 271, 4 Del. Code Annotated (1953), which provided in part that a corporation could sell, lease, or exchange all of its property and assets upon such terms and conditions and for such consideration as its board of directors deems expedient, "when and as authorized by the affirmative vote of the holders of a majority of the stock issued and outstanding."[4]

Petitioner did not have a fixed, unconditional and enforceable right to receive the stock until its stockholders approved the settlement on April 22, 1960, and, therefore, the income was not properly accruable until that date. Section 451(a) of the Internal Revenue Code of 1954 (26 U.S.C.); Section 1.451-1(a) of the Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.). See *United States* v. *Safety Car Heating & Lighting Co.*, 297 U.S. 88; *Lucas* v. *North Texas Co.*, 281 U.S. 11. Thus, petitioner's contention (Pet. 19) that the transaction should be considered as completed when the boards of directors approved the settlement discounts entirely the importance and legal significance of the role of petitioner's shareholders.

3. Petitioner further asserts (Pet. 9-11) that the decision below is contrary to the rationale of *United States* v. *Davis*,

[4]Although petitioner asserts (Pet. 4-5) that the Delaware statute did not require shareholder approval, the draft of the proposed settlement dated February 18, 1960, provided that the agreement was subject to the condition that "the proposal has received the affirmative vote of the majority of all the outstanding shares of Mesabi stock [or such lesser number as the parties may agree are required by Delaware law], the shares held by Reserve not to be voted," and the parties did not agree upon a lesser number.

370 U.S. 65. There, in 1954, the taxpayer, apparently on a cash basis, and his then wife agreed to a voluntary property settlement and separation agreement providing for, *inter alia*, the transfer of certain of taxpayer's property, including 1,000 shares of DuPont stock, to his wife. One-half of this stock was transferred in the tax year involved, 1955, and the other half was transferred thereafter. This Court, having first determined that the transaction was a taxable event, held that the measurement of the taxable gain realized by that taxpayer was the value of the stock *at the date of its transfer*. The *Davis* measurement of the cash basis taxpayer's gain as of the date of the transfer is directly analogous to the Court of Claims' decision here that the value of the stock petitioner received should be measured as of the date it acquired a fixed and enforceable right to receive the stock and upon which it was required to accrue its receipt into income. Thus, *Davis* supports rather than conflicts with the decision below.

4. Contrary to petitioner's additional assertion (Pet. 15-17), the Court of Claims correctly concluded that the enhancement principle in determining just compensation in condemnation cases should not be extended to this situation (Pet. App. 21a-23a). In discussing the rules governing the determination of just compensation this Court in *United States* v. *Cors*, 337 U.S. 325, 333-334, stated:

> It is not fair that the government be required to pay the enhanced price which its demand alone has created. That enhancement reflects elements of the value that was created by the urgency of its need for the article. It does not reflect what "*a willing buyer would pay in cash to a willing seller,*" * * * *in a fair market.* * * * [T]he enhanced value reflects speculation as to what the government can be compelled to pay. That is a hold-up value, not a

> fair market value. That is a value which the government itself created and hence in fairness should not be required to pay. [Emphasis added.][5]

The foregoing description of the rationale of the enhancement principle demonstrates that it was developed to deal with the special situation in condemnation where the alleged value did not reflect an arm's-length price. But that rationale has no application to the question in this income tax case as to which of two measures, representing the fair market value of stock at different times, should be used by the recipient of such stock. At all events, as the Court of Claims noted, the enhancement rationale would not have been applicable on the facts because (Pet. App. 22a): (1) if the value of the shares was enhanced because of the settlement, unlike the condemnation cases, that enhancement was due to the actions of both petitioner (the buyer) and Reserve (the seller) and the increase was not attributable to petitioner's special need for the property which itself pushed the price upwards; (2) petitioner did not prove what part of the increase was due to the settlement and what part to Reserve's separate plan to increase production and petitioner's change-over from corporate to trust form; and (3) petitioner could have resold the stock at its enhanced value and reaped the benefits of the enhancement.[6]

5. Finally, petitioner argues (Pet. 5, 11, 17-19) that use of the accrual date as the valuation date leaves the parties unable to determine in advance the tax consequences of a transaction in which actively traded stock is exchanged. The Court of Claims correctly rejected this contention,

[5] See also *United States* v. *Reynolds*, 397 U.S. 14, 16-18.

[6] While petitioner asserts (Pet. 17) that the reduction in outstanding shares would tend to cause the market price of the remaining shares to rise, there is no probative evidence in the record to support that assertion.

observing (Pet. App. 14a) that "the participants could agree on a purchase price and provide that it would be paid in 'x' shares of stock at the market price on the final date of agreement plus or minus a cash balancer."

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

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